83-1026

No. .....

In the Supreme Court of the United States

OCTOBER TERM, 1983

LINDE THOMSON VAN DYKE FAIRCHILD & LANGWORTHY;
SOUTHGATE BANK & TRUST CO.,
Petitioners,

v.

T. J. RANEY & SONS, INC., Individually and as Representative Party on Behalf of All Other Persons Similarly Situated,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Roy J. Davis*
Don G. Hollaway
L. Gene Gist
ANDREWS DAVIS LEGG BIXLER
MILSTEN & MURRAH
500 West Main
Oklahoma City, Oklahoma 73102
(405) 272-9241
Attorneys for Petitioner, Linde Thomson Van Dyke Fairchild & Langworthy

Harry A. Woods, Jr.*
Judy Hamilton Morse
CROWE & DUNLEVY
1800 Mid-America Tower
20 North Broadway
Oklahoma City, Oklahoma 73102
(405) 235-7700
Attorneys for Petitioner, Southgate Bank & Trust Co.

December, 1983

*Counsel of Record.

QUESTIONS PRESENTED

1. In an action involving an initial public offering, is reliance by a bond purchaser on the integrity of the market sufficient to state a claim under Rule 10b-5?
2. Can a plaintiff, who admittedly purchased its bonds after default with knowledge that the bonds may have no value, establish causation in a Rule 10b-5 action by alleging that but for the fraud the bonds would not have been on the market?
3. Is some type of reliance, other than reliance on the integrity of the market, necessary in a 10b-5 action involving an initial public offering and affirmative misrepresentations?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

AUTHORITIES CONTINUED — PAGE(S)

Statutes and Codes

Legislative Materials

No. .....

In the
Supreme Court of the United States
OCTOBER TERM, 1983

LINDE THOMSON VAN DYKE FAIRCHILD & LANGWORTHY;
SOUTHGATE BANK & TRUST CO.,
Petitioners,

v.

T. J. RANEY & SONS, INC., Individually and as
Representative Party on Behalf of All
Other Persons Similarly Situated,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners Linde Thomson Van Dyke Fairchild & Langworthy, now a professional corporation engaged in the practice of law under the name of Linde Thomson Fairchild Langworthy Kohn & Van Dyke, and Southgate Bank & Trust Co., pray that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Tenth Circuit.

OPINIONS BELOW

The judgment of the United States Court of Appeals for the Tenth Circuit, reported at Fed.Sec.L.Rep. (CCH) ¶99,503 (10th Cir. Sept. 26, 1983), is printed as Appendix A. The unreported opinions of the United States District Court for the Western District of Oklahoma are printed as Appendices B and C.

JURISDICTION

The judgment of the Court of Appeals was entered on September 26, 1983 (App. A). A petition for rehearing was not filed. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTES INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j (1976), and Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5, are set forth as Appendix D.

STATEMENT OF THE CASE

The class action plaintiff, T. J. Raney & Sons, Inc. ("Raney"), is a sophisticated broker-dealer of securities which buys and sells municipal and other tax-exempt bonds.[1] Raney acted as a distributor for the Ft. Cobb, Oklahoma, Irrigation Fuel Authority ("Ft. Cobb Authority") Series C Bonds issued in 1973. The Ft. Cobb Authority was created in 1969 as a public trust to construct and equip a natural gas distribution facility. The initial construction and expansion of the gas distribution facility was funded by two prior bond issues. Series C Bonds in the principal amount of $1,500,000 were issued and sold so that two additional gas distribution systems could be constructed.

---

[1] Raney is the corporate successor to three other Raney entities which existed prior to January 1, 1975: Raney Brothers, Inc., Raney Securities, Inc. and T. J. Raney & Sons, a partnership. The name "Raney" will be used in reference to any of the Raney entities.

Petitioners are the law firm of Linde Thomson Van Dyke Fairchild and Langworthy[2] ("Linde Thomson") and Southgate Bank & Trust Co. ("Southgate"). Linde Thomson rendered the bond opinion on the Series C Bonds, and Southgate served as the paying agent for that issue.

In August, 1975, the Series C Bonds defaulted. Raney did not own any Series C Bonds at the time of default. After notice of the default, several Series C purchasers to whom Raney had sold the bonds complained to Raney. With notice and actual knowledge of the default, Raney decided to repurchase some Series C Bonds from its disgruntled customers. Raney repurchased $50,000 of Series C Bonds from one customer for $.90 on the dollar and $5,000 of Series C Bonds from another customer for $.35 on the dollar. It is this $55,000 of Series C Bonds upon which Raney bases its current claim.

During discovery Raney admitted that it did not purchase any of its bonds for investment purposes or for resale, but primarily as a public relations effort to soothe unhappy customers. Raney further admitted that it purchased the Series C Bonds fully cognizant that there were problems with the issue. Class counsel has admitted that Raney purchased with knowledge that the bonds might not be worth anything, and Raney's own accountant testified that these bonds were never carried as an asset on Raney's books but were written off as a tax loss less than six months after they were purchased.

---

[2] Since this action was filed the Petitioner Linde Thomson has become a professional corporation under the name of Linde Thomson Fairchild Langworthy Kohn & Van Dyke.

Only Raney, of all Series C bondholders, purchased its bonds with full knowledge of the default and of the fact that the bonds very possibly had no market value.

Following its purchase of the defaulted Series C Bonds, Raney commenced this action in July, 1976, invoking the District Court's jurisdiction under Section 22(a) of the Securities Act of 1933, 15 U.S.C. §77v(a), and Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. §78aa. Despite its unique position, Raney filed its suit as a class action, seeking to represent a class of all persons who purchased Series C Bonds "prior to the time when it became common knowledge among the investing community that the bond sale proceeds were not used to construct, equip or acquire additional gas facilities." In its Amended, Substituted and Restated Complaint Raney alleged that the defendants, "acting singly and in concert, aiding and abetting each other," falsely represented that:

(1) the proceeds of the bond issue would be used to construct, equip and acquire two additional gas distribution facilities for the Ft. Cobb Authority, and

(2) the Ft. Cobb bonds were legally issued.[3]

Raney alleged that these misrepresentations resulted in violations of Section 10(b) of the Securities Exchange Act of

---

[3] Approximately four years after the commencement of this lawsuit, the District Court before whom the Ft. Cobb Authority Chapter IX bankruptcy proceedings were pending held on March 27, 1979, that the Ft. Cobb Authority was not a valid public trust since the beneficial interest of the trust had not been properly accepted as contemplated by the Oklahoma Public Trust Act, Okla. Stat. tit. 60, §§176-180. *In re: Ft. Cobb, Oklahoma Irrigation Fuel Authority*, 468 F.Supp. 338 (W.D. Okla. 1979).

1934 and SEC Rule 10b-5 and constituted common law fraud.

The action was certified as a class action in 1979 by the District Court for the Western District of Oklahoma. Subsequent to the class certification Petitioner Southgate was added as a defendant, and significant counterclaims were filed against Raney based on Raney's participation in the sale of all three issues of Ft. Cobb bonds. With the District Court's permission, Petitioners filed a joint motion for decertification of the class based primarly on Raney's inadequacy as a class representative. While acknowledging that Raney was in a unique position as compared to other Series C bond purchasers, the District Court overruled Petitioners' motion to decertify the class (App. B). The District Court based its decision on the ground that Raney might have a 10b-5 claim in its own right under the newly articulated standards set forth in *Shores* v. *Sklar*, 610 F.2d 235 (5th Cir. 1980) (App. B, p. 6b).

Subsequent to its ruling, the District Court certified the following issue for interlocutory appeal:

> Under the facts alleged herein, can a 10b-5 action be maintained on the theory announced in *Shores* v. *Sklar, supra,* i.e. reliance by a bond purchaser on the integrity of the market is sufficient in the context of a pervasive fraud that would, if known, prevent the security from being marketable. In practical terms, the question is what must be shown at the trial to prove causation in light of the varying standards of *Affiliated Ute, supra, Holdsworth* v. *Strong, supra,* and *Shores* v. *Sklar, supra.*

(App. C, p. 6c).

On appeal a panel of the United States Court of Appeals for the Tenth Circuit affirmed the District Court's ruling. In reaching its decision the Tenth Circuit acknowledged that "[t]he courts have not been unanimous in extending a fraud on the market theory to newly issued securities" (App. A, p. 5a), but nevertheless found the "reasoning in *Shores* v. *Sklar* to be persuasive" (App. A, p. 5a). The court further noted that in holding that Raney had stated sufficient grounds for relief it was merely extending "the protection of Rule 10b-5 to those cases in which the securities were not qualified legally to be issued, and as the act states there was a scheme to defraud or act to defraud" (App. A, p. 6a). The court held that Raney had stated a claim by alleging that:

> [T]he defendants knowingly conspired to bring unlawfully issued Series C bonds to market with the intent to defraud, that it reasonably relied on the availability of the bonds as indicating their lawful issuance, and that it suffered injury resulting from the purchase of the bonds.

(App. A, p. 6a). In so holding the court concluded that "the causation element was fulfilled by proof that but for the conspiracy and the acts committed pursuant to it, the securities could not have been issued" (App. A, p. 6a).

REASONS FOR ALLOWANCE OF THE WRIT

I. Significant and Recurring Questions As to the Definition and Parameters of the "Fraud-on-the-Market" Theory of Causation in Rule 10b-5 Actions Have Created a Divergence Among the Circuits As to the Intent and Meaning of That Rule of Law.

The Tenth Circuit opinion, which allows a bond purchaser who is fully aware that he is buying defaulted bonds to establish reliance by alleging that the bonds were on the market as a result of fraud, could have an unparalleled effect on securities fraud litigation. The Tenth Circuit's opinion, while representing an unprecedented rule of law, does not represent an isolated fact pattern.

Federal courts have been confronted more and more with troublesome questions revolving around whether the reliance requirement in a 10b-5 action can be satisfied by a purchaser who, when making his investment decision, admittedly did not rely on any representations made by any particular defendant.[4] Utilizing the "fraud-on-the-market"

---

[4] The importance of this question is highlighted by the number of courts which have been called on to address this issue: *Wilson* v. *Comtech Telecommunications Corp.*, 648 F.2d 88 (2d Cir. 1981); *Huddleston* v. *Herman & MacLean*, 640 F.2d 534 (5th Cir. 1981), *mod. in part* and *reh'g denied*, 650 F.2d 815 (5th Cir. 1981), *cert. granted*, 102 S.Ct. 1766 (1982), *aff'd in part* and *rev'd in part*, 103 S.Ct. 683 (1983); *Shores* v. *Sklar*, 610 F.2d 235 (5th Cir. 1980), *reh'g en banc granted*, 617 F.2d 441 (5th Cir. 1980), *aff'd*, 647 F.2d 462 (5th Cir. 1981), *cert. denied*, 103 S.Ct. 722 (1983); *Vervaecke* v. *Chiles, Heider & Co.*, 578 F.2d 713 (8th Cir. 1978); *Arthur Young & Co.* v. *United States District Court*, 549 F.2d 686 (9th Cir. 1977), *cert. denied*, 434 U.S. 829 (1977); *Blackie* v. *Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976); *Kennedy* v. *Nicastro*, 517 F.Supp. 1157 (N.D. Ill. 1981); *Jezarian* v. *Csapo* [1980 Transfer Binder], Fed Sec.L.Rep. (CCH) ¶97,692 (S.D.N.Y. Nov. 12, 1980).

theory of causation, at least three different circuit courts have responded to this question with three different answers, creating ambiguity and confusion in securities fraud litigation.

Initially, the Ninth Circuit in *Blackie* v. *Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976), determined that, in an action based on fraud effected through an impersonal secondary market rather than face-to-face transactions, direct reliance by the plaintiff on the defendants' misrepresentations may not be necessary. The court found that fraud of this type involved market manipulation, distortion of market prices and courses of conduct designed to affect artificially the price of stock in the impersonal stock exchange context. Under these circumstances the court noted that it would be very difficult for a purchaser to establish reliance on a particular misrepresentation by a defendant. The court reasoned that in reality the defendants' conduct was a "fraud-on-the-market" as opposed to any particular individual. Under these facts the Ninth Circuit held that a plaintiff is entitled to a presumption that he relied on the false information which was filtered through market mechanisms and ultimately reflected in inflated prices. The presumption of reliance allowed by the court recognized the market's role as a transmission belt linking a misrepresentation and the individual purchaser or seller. However, the presumption of reliance allowed in *Blackie* was not absolute and could be rebutted by proof that the plaintiff relied on something other than the false information when making his investment decision.

Recently, the Fifth Circuit in *Shores* v. *Sklar*, 610 F.2d 235 (5th Cir. 1980), *reh'g en banc granted*, 617 F.2d 441

(5th Cir. 1980), *aff'd*, 647 F.2d 462 (5th Cir. 1981), *cert. denied*, 103 S.Ct. 722 (1983), announced in a sharply divided opinion an unprecedented rule of law that expanded the scope of Rule 10b-5 and the "fraud-on-the-market" theory beyond any previous judicial or legislative authority. Unlike *Blackie*, the *Shores* case did not involve secondary market trading but involved an initial public offering with face-to-face transactions. The court held that, even though it was undisputed that the plantiff had not relied on the misrepresentations of the defendants, he could, nevertheless, recover under Rule 10b-5 if he could prove that the bonds in question were not "entitled to be marketed." The majority reasoned that purchasers are entitled to rely on the integrity of the market to furnish them securities that are "entitled to be marketed." Thus, under *Shores*, purchasers do not have to prove reliance on affirmative misrepresentations but rather can merely show reliance on the integrity of the market in order to maintain a 10b-5 claim.

Although likening its holding to the "'fraud-on-the-market" theory set forth in *Blackie*, *Shores* created a novel "but for" causation standard, *i.e.*, "but for" the acts of the defendants the bonds would not have been available for purchase and, thus, the plaintiff would not have suffered economic harm. This holding is diametrically opposed to *Blackie*. *Blackie* made clear that the absence of transaction causation (the acts of the defendants caused the plaintiff's investment not just the plaintiff's loss) could not be cured by a "fraud-on-the-market" theory. *Blackie*, 524 F.2d at 891; *see also, Jezarian* v. *Csapo* [1980 Transfer Binder] Fed. Sec.L.Rep. (CCH) ¶97,692 (S.D.N.Y. Nov. 12, 1980).

Furthermore, the "market reliance" described in *Shores* is significantly different than that discussed in *Blackie*. Under the *Blackie* analysis the plaintiff in *Shores* would not have prevailed since the presumption of reliance allowed in *Blackie* would have been rebutted by the plaintiff's admissions that he relied on his broker, *i.e.*, not the integrity of the market. Thus, "market reliance" under the rule in *Shores* is apparently something more than the presumption of reliance allowed in *Blackie*.

Since *Shores'* "market reliance" does not involve indirect reliance on false information filtered through the market, it cannot be characterized as a true "fraud-on-the-market" case. Yet *Shores* has taken that doctrine and unilaterally extended its boundaries to justify a rule of law which finds no support in the decisions of this Court and which is inconsistent with established precedence regarding reliance, either direct or indirect, as a fundamental element of a Rule 10b-5 action. *Wilson* v. *Comtech Telecommunications Corp.*, 648 F.2d 88 (2d Cir. 1981); *Huddleston* v. *Herman & MacLean*, 640 F.2d 534, 536 (5th Cir. 1981), *mod. in part* and *reh'g denied*, 650 F.2d 815 (5th Cir. 1981), *cert. granted*, 102 S.Ct. 1766 (1982), *aff'd in part* and *rev'd in part*, 103 S.Ct. 683 (1983); *Holdsworth* v. *Strong*, 545 F.2d 687 (10th Cir. 1976), *cert. denied*, 430 U.S. 955 (1977); *Clegg* v. *Conk*, 507 F.2d 1351 (10th Cir. 1974), *cert. denied*, 422 U.S. 1007 (1975); *Sharp* v. *Coopers & Lybrand* [1981 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶97,971 (3d Cir. April 28, 1981).

The instant Tenth Circuit opinion has taken the "fraud-on-the-market" theory, redefined it, and expanded it even beyond the parameters contemplated in *Shores*. The unique

holding of the court below now permits recovery by plaintiffs who not only do not rely on any alleged misrepresentations of the defendants but who purchase their securities after default and with full knowledge that there may be substantial problems with the issue. The opinion of the Circuit Court is a departure from the prior rule which had existed in the Tenth Circuit for a substantial period of time that, in a case involving affirmative misrepresentations, the plaintiff has the burden of proving that he relied on such misrepresentations. *Holdsworth* v. *Strong*, 545 F.2d at 687.

Recovery under the new "fraud-on-the-market" test announced by the Tenth Circuit turns not on whether the fraud was so pervasive that the bonds were not entitled to be marketed as set forth in *Shores*, but on whether the securities were "qualified legally to be issued" (App. A, p. 6a). Under the auspices of adopting the "fraud-on-the-market" theory of causation, but in actuality contrary to the holding in *Blackie*, the court specifically held that the "causation element was fulfilled by proof that but for the conspiracy and the acts committed pursuant to it, the securities could not have been issued" (App. A, p. 6a).

This holding completely eviscerates reliance as a meaningful element in a 10b-5 action by allowing a plaintiff to satisfy the causation requirement by simply establishing that the bonds were on the market pursuant to a fraudulent conspiracy, regardless of the plaintiff's knowledge or what information the plaintiff utilized in making his decision to purchase the securities. The court's holding allows reliance and causation to "flow from a showing of some abstract wrong," a test which the same court previously rejected in *Holdsworth*.

Not only does the Tenth Circuit opinion contradict its holding in *Holdsworth*, but the opinion of the lower court in no way resembles the "fraud-on-the-market" theory of causation discussed in *Blackie*. Nor does it articulate the same rule of law found in the *Shores* decision. In *Shores* the court narrowed the scope of its holding by requiring a plaintiff proceeding under its theory of recovery to prove that the security would not have been marketed at all except for the alleged fraud and that the security in question had no value as a result of the fraud, as opposed to merely a decreased value. These restrictions do not appear in the Tenth Circuit Opinion. Thus, the Tenth Circuit has created a new type of "fraud-on-the-market" which differs from *Blackie* and *Shores* and which far exceeds the boundaries of even those decisions.

The "fraud-on-the-market" theory of causation first announced in *Blackie* did not alleviate the traditional reliance element from 10b-5 claims, it merely allowed a presumption of reliance which shifted the burden of proof. Subsequent to the *Blackie* decision the Fifth and Tenth Circuits have reached decisions which, while claiming to be within the bounds of the "fraud-on-the-market" theory of causation, have so far departed from the original doctrine that there are significant and recurring questions as to the definition and parameters of the "fraud-on-the-market" theory of causation in Rule 10b-5 actions. The Tenth Circuit opinion is contrary to the well-established construction given Rule 10b-5 and is so inconsistent in theory as to leave the intent and meaning of that statute in a state of confusion.

II. The Tenth Circuit Opinion Conflicts With the Eighth Circuit.

The Tenth Circuit opinion is in direct conflict with the decision of the Eighth Circuit in *Vervaecke* v. *Chiles, Heider & Co.*, 578 F.2d 713 (8th Cir. 1978). In *Vercaecke*, a factually similar case, the plaintiff claimed that an offering circular for bonds contained misrepresentations and material omissions in violation of Rule 10b-5. The plaintiff did not allege reliance because he had not seen the offering circular prior to his purchase. The Eighth Circuit affirmed a summary judgment dismissal of the plaintiff's claim and a finding that the plaintiff was not an adequate representative of a class due to his lack of reliance. The court specifically rejected the plaintiff's argument that his claim did not require positive proof of reliance because it could be cast as an omissions case covered by clauses (1) and (3) of Rule 10b-5.[5]

With virtually identical facts, the Tenth and Fifth Circuits have reached opposite conclusions from those reached by the Eighth Circuit, which demonstrates an irreconcilable conflict between the circuits.

---

[5] The fact that the plaintiff in *Vervaecke* apparently did not seek to recover under a market fraud theory does not distinguish it since neither Raney nor the plaintiff in *Shores* alleged the type of market reliance under which their claims were eventually allowed. The Tenth and Fifth Circuits read a market fraud theory into the plaintiff's complaint, while apparently the Eighth Circuit chose not to do so.

III. The Lower Court's Holding Is an Improper Judicial Legislation of a New Entitlement to Rule 10b-5 Plaintiffs.

The Court of Appeals' expansion of Rule 10b-5 creates a new substantive entitlement for purchasers who were previously foreclosed from recovery by reason of non-reliance. The lower court's judicial legislation is in direct conflict with the intent and purpose of the Securities Exchange Act of 1934 as reflected in the Senate committee report on the Act:

> 8. Civil Liabilities
>
> [T]he bill provides that any person who unlawfully manipulates the price of a security, or who induces transactions in a security by means of false or misleading statements, or who makes a false or misleading statement in the report of a corporation, shall be liable in damages to those who have bought or sold the security at prices affected by such violation or statement. In such case the burden is on the plaintiff to show the violation or the fact that the statement was false or misleading, *and that he relied thereon to his damage.*

S. Rep. No. 792, 73d Cong., 2d Sess. 12-13 (1934) (emphasis added).

This Court has previously held that, in construing implied remedies such as a 10b-5 claim, the central inquiry must be congressional intent. *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979). The legislative history of the 1934 Act demonstrates that it was the intention of Congress that only purchasers who actually relied on the misrepresentations of the defendant should be permitted to recover damages under the Securities Exchange Act. It was

the congressional purpose to restrict recovery to victims of securities fraud, not to create a claim for every purchaser of a security. *See Dupuy* v. *Dupuy*, 551 F.2d 1005, 1016 (5th Cir. 1977), *cert. denied*, 434 U.S. 911 (1977).

The Tenth Circuit has carried the ambit of Rule 10b-5 far beyond the limits of expressed congressional intent in contradiction to this Court's admonition that courts should not act outside the scope of congressional intent, *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977), and should not "judicially creat[e] a damages action . . . [where it] is unnecessary to ensure the fulfillment of Congress' purposes in adopting the . . . Act." *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 41 (1977).

This Court has repeatedly held that the fundamental purpose of the securities laws is to implement a philosophy of full disclosure. *Santa Fe Industries, Inc.*, 430 U.S. at 462; *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972). Rather than promoting full disclosure, the holding of the lower court discourages informed investment decisions by permitting recovery even when a purchaser chooses not to read offering material or even when he is aware that the securities are in default. Under the Tenth Circuit rule, the purchaser who avails himself of information has a more difficult burden to establish causation than the purchaser who can merely allege that he relied on the integrity of the market or, easier yet, the purchaser who can simply allege that the bonds were on the market as a result of fraud and then be relieved of proving any other type of reliance.

The Tenth Circuit opinion is also contrary to precedence established by this Court limiting liability in the area of

securities law violations.[6] The new judicial entitlement created by the lower court will substantially increase the probability of vexatious suits in contravention of this Court's warning that "the inexorable broadening of the class of plaintiffs who may sue in this area of the law will ultimately result in more harm than good." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 214 n.33 (1976); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 747-748 (1975).

IV. Review Is Necessary at This Time Since the Tenth Circuit Opinion Affects Substantive Issues in This Case Regarding *Res Judicata* and Proof of Reliance.

An additional reason why this Court should exercise its discretion to grant review at this time is the effect the lower court's opinion would have on substantive issues in the trial of the instant case.

The lower court's holding that Raney need not prove reliance on any acts of the Petitioners allows Raney to state a claim despite its unique position as a Series C bond purchaser. The opinion therefore permits Raney to continue as class representative and permits the case to proceed as a class action. If the Tenth Circuit is in error then this action should not proceed as a class action because the named

---

[6] *See e.g. Chiarella* v. *United States*, 445 U.S. 222 (1980); *Transamerica Mortg. Advisors, Inc.* v. *Lewis*, 444 U.S. 11 (1979); *Touche, Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *Internat'l Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551 (1979); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977); *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976); and *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975).

plaintiff would be an inadequate representative.[7] If Petitioners are correct in their assertions that Raney is an inadequate representative because it cannot state a claim in its own right, the benefits of *res judicata* could be jeopardized if an absent class member subsequently came forward and asserted Raney's inadequacy. *Hansberry* v. *Lee*, 311 U.S. 32 (1940). This Court's review of the Circuit Court's opinion at this time, instead of at a later date, would prevent such problems and avoid the possibility of duplicative and unnecessary litigation.

In addition, the holding of the lower court is crucial to the substantive issues in this case regarding proof of reliance. This will become evident when the District Court reaches the point when it must instruct the jury on the burden of proof with respect to the absence of reliance. Should Petitioners be correct that the lower court's holding is in error, the placing of the burden of proof with respect to reliance in the trial of this matter would be erroneous, thus causing a substantial waste of judicial time and effort.

---

[7] The District Court in its Order certifying the interlocutory appeal acknowledged that it might well be required to re-examine the issue of class certification if the Tenth Circuit required Raney to meet the traditional reliance requirements of 10b-5 actions. (App. C, p. 7c)

CONCLUSION

The petition for a writ of certiorari should be granted.

Roy J. Davis*
Don G. Holladay
L. Gene Gist
ANDREWS DAVIS LEGG BIXLER
MILSTEN & MURRAH
500 West Main
Oklahoma City, Oklahoma 73102
(405) 272-9241

Attorneys for Petitioner,
Linde Thomson Van Dyke
Fairchild & Langworthy

Harry A. Woods, Jr.*
Judy Hamilton Morse
CROWE & DUNLEVY
1800 Mid-America Tower
20 North Broadway
Oklahoma City, Oklahoma 73102
(405) 235-7700

Attorneys for Petitioner,
Southgate Bank & Trust Co.

December, 1983

*Counsel of Record

APPENDIX A

PUBLISH

[Filed Sept. 26, 1983]

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

81-2270

T. J. RANEY & SONS, INC., individually and as representative party on behalf of all other persons similarly situated, Plaintiff-Appellee, v. FORT COBB, OKLAHOMA IRRIGATION FUEL AUTHORITY, a trust created under the laws of the State of the State of Oklahoma, EUFAULA ENTERPRISES, INC., an Oklahoma corporation, GLENN C. HATFIELD, SR., GLENN C. HATFIELD, JR., JOHN I. WILLHAUCK, JR., K. R. ADAMS, NORMAN E. LEWIS, JACK L. PERRY, PERRY, ADAMS & LEWIS, INC., a Missouri corporation, and RIMROCK GAS COMPANY, a Texas corporation, Defendants, LINDE, THOMSON, VAN DYKE, FAIRCHILD & LANGWORTHY and SOUTHGATE BANK & TRUST CO., Defendants-Appellants.	Appeal From The United States District Court For The Western District of Oklahoma (D. C. Civil No. 76-554-BT)

Harry A. Woods, Jr. (Judy Hamilton Morse, with him on the brief), of Crowe & Dunlevy, P.C., Oklahoma City, Oklahoma, for Defendant-Appellant Southgate Bank & Trust Co.

Roy J. Davis, Don G. Holladay and L. Gene Gist of Andrews, Davis, Legg, Bixler, Milsten & Murrah, Oklahoma City, Oklahoma, on the brief for Defendant-Appellant Linde, Thomson, Van Dyke, Fairchild & Langworthy.

Larry W. Burks of Friday, Eldredge & Clark, Little Rock, Arkansas (James D. Fellers of Fellers, Snider, Blankenship & Bailey, Oklahoma City, Oklahoma, with him on the brief), for Plaintiff-Appellee.

Before SETH, Chief Judge, McWILLIAMS, Circuit Judge, and BROWN, District Judge*.

SETH, Chief Judge.

This is an interlocutory appeal from the trial court's denial of the defendants' motion to decertify the underlying action as a class action. This question necessarily requires an answer as to whether this circuit should adopt some form of the fraud on the market theory in securities litigation arising under Rule 10b-5. *See* Bowe v. First of Denver Mortgage Investors, 562 F.2d 640 (10th Cir.), and West v. Capitol Federal Sav. and Loan Association, 558 F.2d 977 (10th Cir.).

The plaintiff, T. J. Raney & Sons, Inc., is a broker-dealer of securities. Raney was involved in the distribution of Series C bonds of the Fort Cobb, Oklahoma Irrigation Fuel Authority. The proceeds of the bonds were to be used for the construction or acquisition of a gas distribution facility.

---

*Honorable Wesley E. Brown, United States Senior District Judge for the District of Kansas, sitting by designation.

Raney alleges that the bond proceeds were commingled with other funds of the project's sponsors and were in fact never used for their intended purpose. Raney also claims that the bonds were not lawfully issued according to Oklahoma law. One of the defendants served as the Authority's bond counsel and issued a bond opinion on the Series C bonds. Raney claims that the bond counsel recklessly passed on the validity of the bonds and thereafter concealed the wrongful divergence of the bond proceeds. The Series C bonds went into default.

Raney seeks to represent all Series C bond purchasers in their claims against the Authority. Apparently there are approximately 60 Series C bondholders and the smallest claim is $5,000. The record discloses that the bondholders have varying degrees of investment experience and that the purchasers did not all receive the same information. Some received an allegedly misrepresentational offering circular and the bond counsel's opinion before purchasing. Others did not.

The defendants claim in this appeal that it was inappropriate for the trial court to certify the case as a class action because not all of the class members had relied on the circular and the bond opinion. The defendants further claim that Raney is not a suitable representative if the class was properly certified.

Traditionally a private action brought under SEC Rule 10b-5 is predicated on the plaintiff's actual reliance on the defendant's deception. Reliance is thus the causal nexus between the defendant's conduct and the plaintiff's injury. Actionable conduct under Rule 10b-5 can be accomplished either by misrepresentation or nondisclosure. In traditional cases of misrepresentation the reliance requirement is met upon proof that " 'the misrepresentation is a substantial factor in determining the course of conduct which results in . . . loss.' " Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 102 (10th Cir.), *quoting* List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.).

Recently, several courts have adopted a theory which allows a plaintiff to rely on the integrity of the market rather than requiring direct reliance on the defendant's conduct. *See, e.g.*, Panzirer v. Wolf, 663 F.2d 365 (2d Cir.); Shores v. Sklar, 647 F.2d 462 (5th Cir.) (*en banc*); Blackie v. Barrack, 524 F.2d 891 (9th Cir.). Subjective reliance on particular misrepresentations is thus not a distinct element of proof of 10b-5 claims. *Blackie, supra*, at 905, 06.

The theory is grounded on the assumption that the market price reflects all known material information. Material misinformation will theoretically cause the artificial inflation or deflation of the stock price. At its simplest the theory requires only that a plaintiff prove purchase of a security and that a material misrepresentation was made concerning the security by the defendant which resulted in an artificial change in price.

The majority of cases which accept some form of fraud on the market theory have concerned securities traded on impersonal, actively traded markets. *See, e.g.*, Panzirer v. Wolf, 663 F.2d 365 (2d Cir.); Zweig v. Hearst Corp., 594 F.2d 1261 (9th Cir.); Blackie v. Barrack, 524 F.2d 891 (9th Cir.); In re LTV Securities Litigation, 88 F.R.D. 134 (N.D. Tex.). Those cases thus argue for adoption of the fraud on the market theory in those situations in which developed securities are actively traded. A leading case to examine the fraud arising from bonds which were not lawfully issued is Shores v. Sklar, 647 F.2d 462 (5th Cir.). The *en banc* court was almost equally divided. In *Shores*, the plaintiff purchased industrial revenue bonds. The Fifth Circuit held that although the plaintiff could not rely on the offering circular as he had not read it, he nevertheless under his allegations of fraud was entitled to 10b-5 relief if he could prove "that (1) the defendants knowingly conspired to bring securities onto the market which were not entitled to be marketed, intending to defraud purchasers, (2) [the plaintiff] reasonably relied on the Bonds' availability on the market as an indication of their apparent genuineness,

and (3) as a result of the scheme to defraud [the plaintiff] suffered a loss." 647 F.2d, at 469-70.

In Arthur Young & Co. v. United States District Court, 549 F.2d 686 (9th Cir.), the court allowed the petitioners to proceed under the theory that "but for" causation was satisfied by the petitioners' reliance on the integrity of the regulatory process. The court allowed submission of SEC disclosure filings connected with the offering of the limited partnership interests for reliance on market integrity. It there said, 549 F.2d at 695: "[T]he purchaser of an original issue security relies, at least indirectly, on the integrity of the regulatory process and the truth of any representations made to the appropriate agencies and the investors at the time of the original issue."

The courts have not been unanimous in extending a fraud on the market theory to newly issued securities. In Vervaecke v. Chiles, Heider & Co., 578 F.2d 713 (8th Cir.), the court held that the plaintiff had to prove reliance on misrepresentations allegedly occurring in the offering circular of certain unregistered municipal bonds in order to be entitled to 10b-5 relief.

This circuit has not yet addressed the fraud on the market theory. Our case of Zobrist v. Coal-X, Inc., 708 F.2d 1511 (10th Cir.), imputes knowledge of risk disclaimers contained in a new issue's offering circular to a purchaser who did not read the circular prior to buying the securities. *Zobrist*, however, does not consider the issues in the case before us. Neither does the Supreme Court's holding in Santa Fe Industries, Inc. v. Green, 430 U.S. 462, dictate the outcome of this appeal.

We find the Fifth Circuit's reasoning in *Shores* v. *Sklar* to be persuasive. Federal and state regulation of new securities at a minimum should permit a purchaser to assume that the securities were lawfully issued. This holding does not imply in any way that the regulatory body considers the worth of the security nor the veracity of the represen-

tations made in the offering circular nor does it "establish a scheme of investors' insurance." List v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir.). It merely extends the protection of Rule 10b-5 to those cases in which the securities were not qualified legally to be issued, and as the act states there was a scheme to defaud or act to defraud.

In this case the trial court in the Fort Cobb Authority Chapter IX proceedings specifically found that "[t]he Fort Cobb, Oklahoma, Irrigation Fuel Authority is thus not a valid public trust . . ." 468 F.Supp. 338, 343 (W.D. Okla.), *appeal dismissed*, June 24, 1980 (10th Cir.). The Authority was thus prohibited from issuing any bonds by Oklahoma law. 60 Okla. Stat. Ann. § 176(d). We therefore hold that the plaintiff has stated grounds for relief by alleging that the defendants knowingly conspired to bring unlawfully issued Series C bonds to market with the intent to defraud, that it reasonably relied on the availability of the bonds as indicating their lawful issuance, and that it suffered injury resulting from the purchase of the bonds.

In Affiliated Ute Citizens v. United States, 406 U.S. 128, the Court held that proof of reliance is not necessary in failure to disclose cases. In the case before us the materiality element has been satisfied here by the claim of conspiracy to bring unlawful issuances to market. Here the causation element was fulfilled by proof that but for the conspiracy and the acts committed pursuant to it, the securities could not have been issued. *See* Shores v. Sklar, 647 F.2d at 469. Securities laws "must be interpreted flexibly and progressively, not technically nor grudgingly, to fairly effectuate their remedial purpose." Clegg v. Conk, 507 F.2d 1351, 1361 (10th Cir.).

The defendants also argue that the plaintiff is not a suitable class representative in the underlying action. The trial court has considerable discretion in the certification of the plaintiff class representative. Rex v. Owens ex rel. State of Oklahoma, 585 F.2d 432 (10th Cir.). The trial court

adequately provided for members of the plaintiff class to assert claims against Raney and for the defendants to assert their counterclaims by bifurcating the trial. The trial court did not abuse its discretion in certifying the class and by naming Raney the class representative. We find also that the trial court was well within its discretion in deciding the typicality, manageability, and numerosity issues.

It is the judgment of this court that the judgment of the trial court should be and is hereby AFFIRMED.

APPENDIX B

[Filed June 8, 1981]

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

T. J. RANEY & SONS, INC., Individually and as Representative Party on Behalf of All Other Persons Similarly Situated, Plaintiffs,	)	
vs.	)	
FORT COBB, OKLAHOMA IRRIGATION FUEL AUTHORITY, A Trust Created Under The Laws of the State of Oklahoma; EUFAULA ENTERPRISES, INC., An Oklahoma Corporation; GLENN C. HATFIELD, SR.; GLENN C. HATFIELD, JR.; JOHN I. WILLHAUCK, JR.; K. R. ADAMS; NORMAN E. LEWIS; JACK L. PERRY; PERRY, PERRY, ADAMS & LEWIS, INC.; A Missouri Corporation; RIMROCK GAS COMPANY, A Texas Corporation; LINDE, THOMSON, VAN DYKE, FAIRCHILD & LANGWORTHY; SOUTHGATE BANK & TRUST CO., Defendants.	)	No. CIV-76-0554-BT

ORDER

This matter comes before the Court on a Motion for Decertification of Class by defendants, Linde, Thomson, Van Dyke, Fairchild & Langworthy and Southgate Bank & Trust Co. For the reasons set out below, defendants' Motion for Decertification is hereby denied.

On August 8, 1979, the Court entered an order certifying a class in this case. Subsequent to that order, extensive discovery has taken place and additional evidence has been developed. Furthermore, on May 6, 1980, with leave of

court, plaintiff joined as a party defendant Southgate Bank & Trust Co. In view of these developments and at the request of defendants, the Court re-opened the issue of class certification.

In submitting the Motion for Decertification to the Court, defendants Linde, Thomson and Southgate divided the responsibility for briefing the various issues as follows: Linde, Thomson addressing the question of certification in view of all the circumstances, and Southgate addressing the issue in light of developments subsequent to the court order of August 8, 1979.

In brief, defendant Linde, Thomson argues essentially as follows: (1) the counterclaims against Raney regarding excessive mark-ups and investigations by certain government securities agencies render Raney inadequate as a class representative, and (2) in view of certain "facts" uncovered by merit discovery in this matter, which allegedly suggest culpability, conflicts of interest, and breaches of fiduciary responsibility, Raney is unable to adequately protect the interests of the class.

In the present case, defendants Linde, Thomson and Southgate have filed counterclaims against individual plaintiff Raney for contribution, essentially alleging that certain acts of Raney in the sale of Ft. Cobb bonds constitute violations of Rule 10b-5. It is not in dispute that the act of charging excessive mark-ups may be a violation of the federal securities law. *See e.g. Handley Investment Company v. SEC*, 354 F.2d 64 (10th Cir. 1965). Consequently, a member of the class presently certified could conceivably bring an action against Raney, the present representative of the class. Defendant Linde, Thomson appears to argue that this potential liability disqualifies Raney as a possible representative of the class.

The Court concludes that the potential liability of Raney to its customers does not present an insurmountable obstacle to class representation. As the Court stated

in its order of August 8, 1979, "The conduct complained of in this action involves certain misrepresentations and omissions which purportedly occurred victimizing all purchasers of Series C bonds." Essentially, the primary issues are as follow: (1) whether the Ft. Cobb Irrigation Authority acquired or constructed additional gas distribution facilities as represented, and (2) whether the bonds were in fact tax exempt. While important, any claims investors may have against Raney for possible mark-ups are not related to the primary issues of law and fact in this action. Therefore, the existence of such claims should not preclude Raney from representing the investor class.

The Court notes that if such claims were to become entangled with the primary issues in this case, much confusion would result. Therefore, the Court hereby orders that this case be bifurcated, such that the trial set for September 14, 1981 shall deal only with the question of whether the named defendants are liable to the members of the class of bondholders. Included for determination in this proceeding will be the cross-claim for contribution filed by defendant Linde, Thomson against the Ft. Cobb Authority. The Counterclaims of defendants Linde, Thomson and Southgate are to be tried separately subsequent to that date.

The Court further notes that proceeding in this manner places legal counsel for the class, Mr. Larry W. Burks, in a potentially untenable situation, first pressing the claims of the class against the named defendants and later defending the individual plaintiff Raney against the defendants' counter-claims. However, the Court concludes that this problem is resolved by counsel's representation at the hearing of May 1, 1981 that separate attorneys would be retained by plaintiff Raney for stage two of the bifurcated action.

In brief, defendant Linde, Thomson argues further that investigations by the Securities Exchange Commission and the Arkansas State Securities Division should disqualify Raney as a class representative in this case. However, the

evidence suggests that such investigations focused solely on the mark-up practices of Raney, which are not related to the primary issues of this action. Therefore, the Court concludes that the investigations of Raney do not preclude it from acting as the class representative in the present action.

In asserting that plaintiff Raney cannot adequately protect the interests of the class, defendant Linde, Thomson argues that as a participating broker-dealer, Raney may not serve as the representative of a class of purchasers. In this regard, this Court adopts the reasoning of the Court set out in the order entered August 8, 1979. *Accord Vernon J. Rockler and Company, Inc.* v. *Graphic Enterprises, Inc.*, 52 F.R.D. 335 (D. Minn. 1971). Therefore, this objection to Raney as the class representative cannot be sustained.

Defendant Linde, Thomson argues further that even if Raney is not automatically disqualified by vitrue of its role as a broker-dealer, its liability for securities fraud is both "eminent" and "substantial", thus rendering Raney inadequate as a class representative. In this regard, defendant raises first the issue of mark-ups disposed of above.

Second, Linde, Thomson asserts that Raney breached its fiduciary duty to the class in its dealings with class members by inconsistent and deceptive treatment in its repurchase of Series C bonds. The Court concludes that there is not evidence of bad faith in the bond repurchases of plaintiff Raney sufficient to deny it standing to represent the bondholder class. More importantly, such transactions are not related to the primary issues of this bifurcated action, and should not interfere with the class action portion of this lawsuit.

Linde, Thomson argues further that Raney was aware of the interrelationships alleged to be part of the fraud in the original Complaint as follows:

> "(d) That there were integral relationships, co-officerships, common controlling influences, and conflicts of interest between the Authority, Eufaula, Hatfield, Sr.,

> Hatfield, Jr., Willhauck, Adams, Lewis, Perry, PAL, and Rimrock, which led to, among other things, the wrongful use of the Bond sale proceeds and the overreaching operational arrangement between the Authority and Rimrock." (Complaint, Para. 22(d).

Brief of defendant Linde, Thomson at 15. However, defendant misreads this aspect of the Complaint. The concern is not the interrelationship *per se*, but rather that such interrelationship ". . . *led to*, among other things, the wrongful use of the bond sale proceeds and the overreaching operational arrangement between the Authority and Rimrock." (Emphasis added) There is no suggestion that Raney or any agent thereof was aware that such interrelationships had contributed to fraud in this case. Consequently, this objection to Raney as a class representative cannot be sustained.

Linde, Thomson argues further that ". . . not only must class counsel be qualified and experienced, but that class counsel must be free of competing interests and divided loyalties among class members." Brief of Defendant, Linde, Thomson at 16. Defendant asserts that plaintiff's counsel will be in a dual role acting as both representative of the class and defender of plaintiff Raney in regard to claims of securities violations. Since such claims are not related to the primary misrepresentations at issue in this case, the Court concludes that bifurcation of this action and the personal withdrawal of Mr. Burks from the second phase of this lawsuit should effectively resolve this problem.

Linde,Thomson further argues that counsel Mr. Burks should be disqualified for the role he played in an investigation of plaintiff Raney while an employee of the Securities Exchange Commission. In response, Mr. Burks submitted an affidavit averring that the investigation of Raney by the SEC in no way covered the subject matter of the present class action, and more specifically the primary issues of this lawsuit. The Court concludes that the affidavit,

in conjunction with bifurcation of this action and the personal withdrawal of Mr. Burks from the second phase of this lawsuit, overcomes the challenge by defendant in this regard. Therefore, this objection to plaintiff as the class representative cannot be sustained.

Finally, defendant Linde,Thomson argues that plaintiff Raney has repeatedly breached its fiduciary obligations over the course of this litigation and consequently is unfit to act as the class representative in this matter. The Court has reviewed the alleged breaches and misstatements and concludes that the acts of plaintiff in this regard are not sufficient to disqualify Raney as the representative of the class. Therefore, defendant's objection to Raney in this respect cannot be sustained.

In arguing that plaintiff Raney is not proper as a class representative in this matter, defendant Southgate Bank & Trust Co., argues first that Raney is not typical of the claims and defenses of other members of the class, since Raney purchased Ft. Cobb bonds knowing the Authority was already in default. The result, according to Southgate, is that Raney did not rely on any representations of defendant and therefore has no claim in its own right under rule 10b-5.

In its order of August 8, 1979, the Court considered the fact that Raney only purchased Ft. Cobb bonds after the Authority was in default. Furthermore, since that date, it has been held that reliance is presumed under alleged facts such as these in the same manner as when the defendants have perpetrated a "fraud on the market." *See Shores* v. *Sklar*, 610 F.2d 235 (2nd Cir. 1980). The Court in *Shores* reasoned that proof of reliance is unnecessary since "but for" the alleged fraud of the defendant, the damage would never have occurred. This Court hereby adopts the reasoning of the Second Circuit. Therefore, this aspect of defendant's Motion cannot be sustained.

Defendant Southgate argues further that plaintiff Raney is a broker-dealer and consequently cannot serve as a representative of the class. This issue was fully briefed prior to the Order of the Court entered August 8, 1979. In this regard, the Court adopts the reasoning contained in the Order entered August 8, 1979. *Accord Vernon J. Rockler and Company, Inc.* v. *Graphic Enterprises, Inc.*, 52 F.R.D. 335 (D. Minn. 1971). Therefore, this aspect of defendant's Motion cannot be sustained.

Finally, defendant Southgate asserts that the circumstances that have developed and the acts of plaintiff Raney to date reveal that it is not able to adequately represent the class of bondholders. As noted above, the Court has reviewed the allegations of wrongdoing and finds that there are not sufficient facts to disqualify plaintiff Raney as the representative of the class.

The Court concludes that the Order of the Court entered August 8, 1979 properly treated the issues involved in this case. Therefore, the Court declines to disturb that Order, and defendants' Joint Motion for Decertification is hereby denied.

IT IS SO ORDERED.

Dated this 5 day of *June*, 1981.

(s) *Thomas R. Brett*
THOMAS R. BRETT
UNITED STATES DISTRICT JUDGE

APPENDIX C

[Filed July 14, 1981]

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

T. J. RANEY & SONS, INC., Individually and as Representative Party on Behalf of All Other Persons Similarly Situated, Plaintiffs,	)	
vs.	)	
FORT COBB, OKLAHOMA IRRIGATION FUEL AUTHORITY, A Trust Created Under The Laws of the State of Oklahoma; EUFAULA ENTERPRISES, INC., An Oklahoma Corporation; GLENN C. HATFIELD, SR.; GLENN C. HATFIELD, JR.; K. R. ADAMS; NORMAN E. LEWIS; JACK L. PERRY; PERRY, ADAMS & LEWIS, INC., a Missouri corporation; RIMROCK GAS COMPANY, A Texas corporation; LINDE, THOMSON, VAN DYKE, FAIRCHILD & LANGWORTHY; SOUTHGATE BANK & TRUST CO., Defendants.	)	No. CIV-76-0554-BT

ORDER

This matter comes on defendants' Motion to Amend Interlocutory Order under 28 U.S.C.A. §1292(6). For the reasons set out below, defendants' Motion is hereby sustained.

In applicable part, 28 U.S.C.A. §1292(b) provides as follows:

> "When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is sub-

> stantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal to be taken from such order . . ."

It is settled law that Section 1292(b) is to be used only in exceptional cases. *Milbert* v. *Bison Laboratories, Inc.*, 260 F.2d 431 (3rd Cir. 1958). The initial issue in each case is whether certification under the statute would promote the policies underlying interlocutory appeals, including the avoidance of harm to a party pendente lite from a possibly erroneous interlocutory order and the avoidance of possibly wasted trial time and litigation expense. *E.g. McNulty* v. *Borden, Inc.*, 474 F.Supp. 1111 (E.D. Pa. 1979).

In certifying an order for interlocutory appeal, the district court apparently may submit its own articulation of "the controlling question of law." *See e.g., Johnson* v. *Alldredge*, 488 F.2d 820 (3rd Cir. 1973). However, "once leave to appeal is granted the Court of Appeals is not restricted to a decision of the question of law which in the district judge's view was controlling." *Katz* v. *Carte Blanche Corporation*, 496 F.2d 747, 754 (3rd Cir. 1974) *cert. denied* 419 U.S. 885.

In the present case, the Court entered an Order on June 8, 1981 denying defendants' Motions for Decertification of Class. In applicable part, that order provides as follows:

> "In arguing that plaintiff Raney is not proper as a class representative in this matter, defendant Southgate Bank & Trust Co., argues first that Raney is not typical of the claims and defenses of other members of the class, since Raney purchased Ft. Cobb bonds knowing the Authority was already in default. The result, according to Southgate, is that Raney did not rely on any representations of defendant and therefore has no claim in its own right under rule 10b-5.

"In its order of August 8, 1979, the Court considered the fact that Raney only purchased Ft. Cobb bonds after the Authority was in default. Furthermore, since that date, it has been held that reliance is presumed under alleged facts such as these in the same manner as when the defendants have perpetrated a 'fraud on the market.' *See Shores* v. *Sklar,* 610 F.2d 235 (2nd Cir. 1980). The Court in *Shores* reasoned that proof of reliance is unnecessary since 'but for' the alleged fraud of the defendant, the damage would never have occurred. This Court hereby adopts the reasoning of the Second Circuit. Therefore, this aspect of defendant's Motion cannot be sustained."

In the brief in support of the present motion, defendants argue as follows:

"The Court in its order has determined that Raney's claims are typical of the claims of the absent class members even though Raney only purchased Fort Cobb bonds after the Fort Cobb Fuel Authority was in default. In support of this finding, the Court stated that there would be no need to prove reliance, relying upon the case of *Shores* v. *Sklar,* 610 F.2d 235 (2nd Cir. 1980) *reh. en banc granted,* 617 F.2d 441 (5th Cir. 1980) *aff'd* No. 77-2896 (5th Cir. 1981) (12 to 10 decision). It is respectfully submitted that this Court's reliance upon *Shores* v. *Sklar* is another indication that there are controlling questions of law involved in the Court's order upon which there is substantial ground for difference of opinion. Specifically, as was pointed out in Southgate's Reply Brief Regarding Decertification of Class filed with this Court on April 13, 1981, the *Shores* case relies upon other "fraud on the market" cases only for analogical support and is in all other respects a case of first impression upon which the 5th Circuit granted rehearing and later affirmed in a sharply divided *en banc*

opinion on May 26, 1981. *Shores* is diametrically opposed to the law in this Circuit as set forth in the case of *Holdsworth* v. *Strong*, 545 F.2d 687, 695 (10th Cir. 1976), *cert.* denied 430 U.S. 1955 (1977), where it is stated:

> 'Where, as here, there are affirmative misrepresentations, the problem of proving reliance is the appropriate and decisive way to prove the chain of causation.'

This case is clearly one involving alleged misrepresentations, so that the quoted language in Holdsworth applies.

Not only is this Court's decision to follow the reasoning of *Shores* critical in the determination of whether or not Raney has typical claims and thus can be an adequate representative but also is crucial as to the substantive issues in this case regarding proof of reliance. Should these defendants be correct in their assertion that *Shores* does not accurately reflect the law of this Circuit, not only is this Court's decision regarding class decertification erroneous, but also the placing of the burden of proof with respect to reliance in the trial of this matter may well be erroneous, thus causing a substantial waste of trial time." (Emphasis added)

It is settled that in a 10b-5 action the plaintiff must prove the element of causation. *See e.g., Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128 (1972). When the alleged fraud is based on misrepresentations by the defendant, causation must be shown by proof of reliance on the part of the plaintiff. *Holdsworth* v. *Strong, supra.* However, when the alleged fraud results from "omissions" of fact the plaintiff need only prove that the information not disclosed is material. *See Affiliated Ute, supra,* at 153-154.

In *Shores* v. *Sklar, supra,* plaintiff was a purchaser of revenue bonds issued by the Industrial Development Board

of Frisco City, Alabama to finance the construction of a plant to manufacture mobile homes. Shortly thereafter the business enterprise leasing the premises, ASECo, the sole source of income necessary to amortize the bonds, went into default. As a result the value of the bonds dropped significantly. It later became apparent that the individuals behind the bond issue knew that ASECo did not have the financial capability to engage in the manufacture of mobile homes and related products or to pay the rent necessary to amortize the principal and interest on the bonds.

Plaintiff filed suit under Rule 10b-5 claiming that he was a victim of a pervasive fraud. Plaintiff never saw an Offering Circular prepared by defendants nor knew one existed. He bought the bonds based solely on his broker's oral representations. The district court entered summary judgment for defendants reasoning that plaintiff did not rely on the misrepresentations of defendants, and therefore lacked an element necessary for a claim under Rule 10b-5. However, the Fifth Circuit vacated the judgment concluding that plaintiff had stated a claim sufficient to overcome a Motion for Summary Judgment.

Under the facts in *Shores*, the Fifth Circuit held that in the context of a pervasive fraud underlying the sale of bonds, a bondholder need not show reliance to prove causation since "but for" the fraud the injury to plaintiff would not have resulted. In applicable part, the Court stated:

> "The requisite element of causation in fact would be established if Bishop proved the scheme was intended to and did bring the bonds onto the market fraudulently and proved he relied on the integrity of the offering of the securities market. His lack of reliance on the Offering Circular, only one component of the overall scheme, is not determinative . . ."

Id. at 14.

This Court concludes that the holding of *Shores* is not "diametrically opposed to the law of this Circuit." Rather,

Shores is merely the logical extension of the reasoning enunciated in *Affiliated Ute, supra,* as applied to the provisions of Rule 10b-5(1) and (3).

In the present case, plaintiff was the purchaser of certain revenue bonds issued by the Fort Cobb, Oklahoma Irrigation Fuel Authority. The bonds were ostensibly sold for the purpose of constructing and acquiring natural gas collection and distribution facilities located in and around Eakly, Oklahoma. However, plaintiff alleges that pursuant to the sale "no facilities were ever constructed, equipped, acquired or placed into service as a result of the issue, offer and sale of the bonds." Rather, the proceeds from the bond sales were wrongfully diverted from use by the Authority. Without regard to whether a purchaser relied on the representations of the defendants, plaintiff seeks to represent a class consisting of:

> ". . . all persons who purchased bonds prior to the time when it became common knowledge among the investing community that the bond sale proceeds were not used to construct, equip, or acquire additional gas distribution facilities."

In view of the above, the Court concludes that the record here presents the following issue for certification on interlocutory appeal: Under the facts alleged herein, can a 10b-5 action be maintained on the theory announced in *Shores* v. *Sklar, supra,* i.e., reliance by a bond purchaser on the integrity of the market is sufficient in the context of a pervasive fraud that would, if known, prevent the security from being marketable. In practical terms, the question is what must be shown at trial to prove causation in light of the varying standards of *Affiliated Ute, supra, Holdsworth* v. *Strong, supra,* and *Shores* v. *Sklar, supra.*[1]

---

[1] The Court in *Shores* concluded that "[Plaintiff's] burden of proof will be to show that (1) the defendants knowingly conspired to bring securities onto the market which were not entitled to be marketed, in-

In an Order entered June 8, 1981, the Court adopted the reasoning of *Shores*. However, the Court notes this question has not been addressed previously by the Tenth Circuit.[2] Therefore, the Court recognizes that without a resolution of the certified issue, the ultimate requirements of proof at trial in regard to causation could be erroneous. Furthermore, a rejection of *Shores* by the Tenth Circuit might well require this Court to re-examine the issue of class certification.[3] Clearly, the potential for waste is great if the Court proceeds to trial without first resolving this controlling question of law.[4]

For the reasons set out above, defendants' Motion for Interlocutory Appeal is hereby sustained. Furthermore, in view of the requirements of 28 U.S.C.A. §1292(b), the Court hereby certifies as follows: The issue of law set forth above is a controlling question of law in this case as to which there is substantial ground for difference of

---

[1] (Continued)

tending to defraud purchasers, (2) [Plaintiff] reasonably relied on the bonds' availability on the market as an indication of their apparent genuineness, and (3) as a result of the scheme to defraud, he suffered a loss. *Id.* at 14-15.

[2] Although opposed to interlocutory appeal, plaintiff concedes in brief, "Plaintiffs do recognize that the principles and applications of law described by *Shores* to those factual circumstances have not been addressed by the Tenth Circuit Court of Appeals and, to the undersigned counsel's knowledge, have not been addressed in any other Circuit Court of Appeals." Plaintiff's Response to Motion by Defendants to Amend Interlocutory Order at 6.

[3] In *Shores* v. *Sklar, supra*, the Court noted "On remand, the Court must reconsider the maintainability of this action as a class action as to members of a properly defined class of bond purchasers who did not so rely."

[4] Counsel have advised the Court that the trial in this case will take as long as four weeks.

opinion. Furthermore, an appeal with respect to this issue may materially advance the ultimate termination of the litigation.

IT IS SO ORDERED.

DATED this *10th* day of July, 1981.

(s) *Thomas R. Brett*
THOMAS R. BRETT
UNITED STATES DISTRICT JUDGE
WESTERN DISTRICT OF OKLAHOMA

APPENDIX D

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j (1976), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(June 6, 1934, ch. 404, title I, § 10, 48 Stat. 891.)

Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in

order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

(Sec. 10; 48 Stat. 891; 15 U.S.C. 78j)

(13 FR 8183, Dec. 22, 1948, as amended at 16 FR 7928, Aug. 11, 1951)